IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:	)	Chapter 11
	)	Case No. 11-10884 (MFW)
HARRY AND DAVID HOLDINGS, INC. *et al.*,[1]	)	(Jointly Administered)
	)	Honorable Mary F. Walrath
Debtors.	)	
	)	
	)	
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OBJECTION OF PENSION BENEFIT GUARANTY CORPORATION TO MOTION OF THE DEBTORS FOR AN ORDER (A) DETERMINING THAT THE FINANCIAL REQUIREMENTS FOR A DISTRESS TERMINATION OF THEIR DEFINED BENEFIT PENSION PLAN ARE SATISFIED AND (B) APPROVING A DISTRESS TERMINATION OF THE PENSION PLAN

Pension Benefit Guaranty Corporation ("PBGC") files this Objection to the Motion of Debtors for an Order (A) Determining that the Financial Requirements for a Distress Termination of Their Defined Benefit Pension Plans Are Satisfied and (B) Approving a Distress Termination of the Debtors' Pension Plans ("Motion") (Docket No. 278). The Debtors and PBGC have developed a discovery plan regarding this Motion that was approved by this Court on May 26, 2011. PBGC reserves the right to supplement this Objection as needed.

The Debtors seek a finding from the Court under 29 U.S.C. § 1341(c)(2)(B)(ii)(IV) that, unless their defined benefit pension plan is terminated, each of the Debtors "will be unable to pay [their] debts pursuant to a plan of reorganization and will be unable to continue in business outside the chapter 11 reorganization process" ("Reorganization Test"). If the Debtors' pension plan -- the Harry and David Employees' Pension Plan ("Pension Plan") -- were to terminate,

[1] The Debtors in these chapter 11 cases, along with the last four digits of each Debtor's tax identification number, are: Harry and David Holdings, Inc. (4389), Harry and David (1765), Harry and David Operations, Inc. (1427), Bear Creek Orchards, Inc. (7216), The address for each of the Debtors is: 2500 South Pacific Highway, Medford, Oregon 97501.

PBGC will assume liability for the unfunded pension benefits that the Debtors promised to their employees, possibly as much as $44 million. Additionally, because PBGC's payment of benefits is subject to statutory limits, some of the Pension Plan's participants may see their benefits reduced.

Congress, in formulating the "Reorganization Test," carefully crafted a statutory scheme designed to protect participants and PBGC by limiting distress termination to cases of "severe business hardship."[2] This scheme is a rigorous test of last resort that requires the employer to prove that *but for* the termination of the pension plan, the employer's business will be liquidated.[3] Thus, an employer must demonstrate that it has pursued and exhausted *all* realistic measures short of termination that would make funding and maintaining the pension plan affordable, such as obtaining minimum funding waivers, cutting non-pension expenditures so that more cash is available to satisfy pension funding requirements, and finding investors or lenders who will finance the employer while it continues the pension plan. The rigorous nature of the distress test makes it especially important that this Motion be decided on a fully developed record.

Although PBGC's review is ongoing, it appears the Debtors fall far short of presenting evidence sufficient to meet the rigorous distress test. Nowhere do they show or even allege that the Pension Plan is unaffordable. Their Motion contains no evidence that retaining the Pension Plan would cause "severe business hardship" or require additional amounts of financing or equity investment. The Debtors simply allege that the investors who have agreed to provide their exit equity financing want the Pension Plan to be terminated. Unless Debtors (who have the

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[2] H.R. Rep. No. 99-300, at 279 (1985), *as reprinted in* 1986 U.S.C.C.A.N. 810, 930; *see also In re U.S. Airways Group, Inc.*, 296 B.R. 734, 743 (Bankr. E.D. Va. 2003).

[3] *Id.*

burden of proof) come forward with credible financial projections and other financial information that demonstrate the Pension Plan is not affordable, their Motion must be denied.

I. BACKGROUND

A. The Parties and Bankruptcy Proceedings.

1. PBGC is the federal agency and wholly owned United States corporation that administers the pension insurance program under Title IV of the Employee Retirement Income Security Act of 1974 ("ERISA"), 29 U.S.C. §§ 1301-1461 (2006 & Supp. III 2009), which covers most private defined benefit pension plans. The program guarantees a secure, predictable retirement for approximately 44 million American workers.[4] When a pension plan covered by Title IV terminates without sufficient assets to pay promised benefits, PBGC typically becomes the statutory trustee of the plan and pays covered benefits up to the limits in Title IV.[5]

2. On March 28, 2011, Debtors filed Chapter 11 petitions with this Court. Debtors are operating their businesses and managing their properties as debtors-in-possession pursuant to sections 1107(a) and 1108 of the Bankruptcy Code. On March 29, 2011, this Court ordered the joint administration of Debtors' cases for procedural purposes.

3. The Debtors are either the contributing sponsor of the Pension Plan or members of the contributing sponsor's controlled group, within meaning of ERISA.[6] *See* 29 U.S.C. § 1301(a)(13), (14).

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[4] PBGC 2010 Annual Report at 1, http://www.pbgc.gov/documents/2010_annual_report.pdf.

[5] *See* 29 U.S.C. §§ 1321, 1322, 1361.

[6] A group of trades or business under common control, referred to as a "controlled group," includes, for example, a parent and its 80% owned subsidiaries. Another example includes brother-sister groups of trades or business under common control. See 29 U.S.C. § 1301(14)(A), (B); 26 U.S.C. § 414(b), (c); 26 C.F.R. §§ 1.414(b)-1, 1.414(c)-1, 1.414(c)-2.

4. Pursuant to ERISA, a sponsor of a pension plan covered by Title IV and the sponsor's controlled group members must satisfy certain financial obligations to the plan.[7] These joint and several responsibilities include paying the statutorily required minimum funding contributions to the pension plan[8] and paying insurance premiums to PBGC.[9] If an underfunded pension plan terminates, other liabilities arise in addition to the above – including unfunded benefit liabilities of the plan and a termination premium at the rate of $1,250 per plan participant per year for three years, both payable to PBGC.[10]

5. PBGC files claims for missed minimum funding contributions due prior to and during the bankruptcy, for unpaid premiums, and, contingent on termination, for unfunded benefit liabilities. If a plan termination occurs while the plan sponsor and any controlled group members are attempting to reorganize in Chapter 11, and they ultimately obtain confirmation of a Chapter 11 plan of reorganization, their obligation to PBGC for termination premiums does not arise until after the Chapter 11 plan is confirmed and the Debtors exit bankruptcy.[11] Thus, under those circumstances, termination premiums are not a dischargeable claim or debt within the meaning of 11 U.S.C. §§ 101(5) and 1141.[12]

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[7] *See* 29 U.S.C. §§ 1082(b)(2), 1307(e)(2), 1362.

[8] 26 U.S.C.§ 412(c)(11) (2007) (effective for pension plan years beginning on or before Dec. 31, 2007); 29 U.S.C.A. § 1082(c)(11) (2007) (same); *see also* 26 U.S.C. § 412(b)(1), (2) (2009) (effective for pension plan years beginning after Dec. 31, 2007); 29 U.S.C.A. § 1082(b)(1), (2) (2009) (same).

[9] 29 U.S.C. §§ 1306, 1307(e)(2).

[10] *See* 29 U.S.C. § 1362(b). *See also* 29 U.S.C. § 1306(a)(7), as amended by § 8101(b) the Deficit Reduction Act of 2005 (Pub. L. 109-B171) and by §§ 401(b) and 402(g)(2)(B) of the Pension Protection Act of 2006 (Pub. L. 109-B280).

[11] *See* 29 U.S.C. § 1306(a)(7)(B).

[12] *Pension Benefit Guar. Corp. v. Oneida Ltd.*, 562 F.3d 154, 157 (2d Cir.), *cert. denied*, __ U.S. __, 130 S.Ct. 1022 (2009).

6. PBGC will file approximately $44 million in contingent claims against each of the Debtors for the unfunded benefit liabilities of the Pension Plan pursuant to 29 U.S.C. § 1362, and will also file unliquidated claims against each of the Debtors for any unpaid premiums, penalties and interest pursuant to 29 U.S.C. §§ 1306, 1307, and for unpaid minimum funding contributions pursuant to 26 U.S.C. §§ 412, 430. PBGC estimates that termination of the Pension Plan would give rise to termination premiums of $3,371,250 per year for three years.

7. On May 10, 2011, the Court entered an order approving a Backstop Stock Purchase Agreement ("Backstop Agreement") providing that certain public note holders ("Backstop Providers") are committed to purchase stock in the reorganized Debtors to the extent a rights offering does not raise the full $55,000,000 to repay amounts owing under the debtor-in-possession financing facility. The Backstop Agreement provides that the Backstop Providers' obligations are contingent on the Effective Date having occurred before or "simultaneously with the Closing, which Effective Date shall not be later than the earlier of (i) October 1, 2011, and (ii) the fifteenth (15th) calendar day following the entry of an order confirming the Plan."[13] The Backstop Agreement further requires that the Backstop Providers' obligations be contingent upon Debtors obtaining a "(i) . . . Final Order of the Bankruptcy Court terminating [Debtors'] qualified pension plan ("Pension Plan"), which order shall be reasonably satisfactory to the Debtors and the Requisite Backstop Providers, or (ii) the treatment of the Pension Plan shall otherwise be reasonably satisfactory to the Requisite Backstop Providers."[14]

B. The Motion Seeking Distress Termination.

8. Debtors filed the Distress Motion and a Notice of Motion and Hearing on May 9, 2011 (Docket No. 278). On May 19, 2011, Debtors filed a notice scheduling a hearing with

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[13] Backstop Agreement § 6.1(h).

[14] *Id.* § 6.1(x).

respect to the Distress Motion for June 24, 2011, with responses or objections due on June 3, 2011 (Docket No. 349).

9. On May 26, 2011, the Court held a status conference at which it approved a schedule setting various discovery deadlines, and providing that PBGC file an initial objection to the Motion on June 7, 2011 and a supplemental objection on July 13, 2011. An evidentiary hearing is set for July 22, 2011.

II. ARGUMENT

A. The "Reorganization Test" for a distress termination of a pension plan under ERISA is an extremely rigorous one

10. ERISA provides the exclusive means for the termination of a pension plan.[15] A standard termination requires a plan to have sufficient assets to pay all of the pension plan's promised benefits.[16] A distress termination requires a showing, among other things, that each plan sponsor and controlled group member satisfies one of the statutory financial distress criteria.[17] In addition to a standard termination or distress termination, PBGC can initiate termination of a pension plan pursuant to 29 U.S.C. § 1342.

11. Under the distress termination provisions, a pension plan may terminate only if, *inter alia*:

- The plan administrator provides affected parties, including PBGC and plan participants, written notice of its intent to voluntarily terminate the pension plan at least 60 days in advance, *see* 29 U.S.C. § 1341(a)(2);
- The plan administrator provides PBGC with the information set forth in 29 U.S.C. § 1341(c)(2)(A); and

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15 *See* 29 U.S.C. § 1341(a)(1); *see also Hughes Aircraft Co. v. Jacobson*, 525 U.S. 432, 446 (1999).

16 *See* 29 U.S.C. § 1341(b)(2)(A)(i)(III).

17 *See* 29 U.S.C. § 1341(c)(2)(B).

- PBGC determines that the requirements of 29 U.S.C. § 1341(c)(2)(B) have been met.

29 U.S.C. § 1341(c)(1).

12. Additionally, every controlled group member must qualify under one of the four distress tests set forth in subparagraphs (i) through (iv) of 29 § 1342(c)(2)(B), although it is not necessary for every controlled group member to qualify under the same test.[18]

13. The Debtors seek to terminate the Pension Plans under the "Reorganization in Bankruptcy" test ("Reorganization Test").[19] Under that test, a bankruptcy court is called upon to make a factual determination whether a debtor "will be unable to pay all of its debts pursuant to a plan of reorganization and will be unable to continue in business outside the chapter 11 termination process" unless the pension plan is terminated.[20] The bankruptcy court's determination does not effectuate, and is not tantamount to, termination of the pension plan. Instead, PBGC determines whether the distress requirements are met, and that determination hinges, *in part*, on whether the bankruptcy court makes the requisite factual finding.[21]

14. The legislative history of the distress termination provisions shows that the Debtors' burden of proof is an extremely high one. Congress significantly changed the termination requirements for pension plans in 1986 and 1987. Before these amendments, a plan sponsor could terminate a pension plan for any reason. Congress first enacted the distress

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[18] 29 U.S.C. § 1341(c)(2)(B) ("The requirements of this subparagraph are met if each person who is (as of the proposed termination date) a contributing sponsor of such plan or a member of such sponsor's controlled group meets the requirements of any of the following clauses").

[19] *See* 29 U.S.C. § 1341(c)(2)(B)(ii).

[20] 29 U.S.C. § 1341(c)(2)(B)(ii)(IV); 29 C.F.R. § 4041(c)(2)(iv); *see also In re Kaiser Aluminum Corp.*, 456 F.3d 328, 334 (3d Cir. 2006); *U.S. Airways*, 296 B.R. at 743; *In re Sewell Mfg. Co.*, 195 B.R. 180, 185 (Bankr. N.D. Ga. 1996).

[21] 29 U.S.C. § 1341(c); *see also Kaiser*, 456 F.3d at 334.

termination provisions as part of the Single-Employer Pension Plan Amendment Act of 1986 ("SEPPAA"). Pub. L. No. 99-272, 100 Stat. 237. In doing so, Congress sought to limit employers' ability to voluntarily terminate an unfunded pension plan to cases of severe hardship.

15. The Report of the House Committee on Education and Labor shows that the "policy of the legislation is to limit the ability of plans sponsors to shift liability for guaranteed benefits onto other PBGC premium payers and to avoid responsibility for the payment of certain nonguaranteed benefits, to cases of severe business hardship."[22] The House Report further explained a primary purpose for the distress termination provisions was "to provide for the transfer of unfunded pension liabilities onto the single-employer pension plan termination insurance system only in cases of severe hardship so as to keep the premium costs of such system at a reasonable level."[23] Congress then further clarified the distress criteria in the Pension Protection Act of 1987, Pub. L. No. 100-203, 101 Stat. 1330, when it added the current, and more stringent, Reorganization Test. The comments of Rep. Schulze, one of the conferees, make it clear that distress terminations under the Reorganization Test are to be allowed "only if it otherwise would force the sponsor into liquidation":

> The conference agreement narrowed the ability of a pension plan sponsor to transfer his pension plan obligations to the PBGC by the mere filing of a bankruptcy petition under chapter 11. Under the conference agreement a bankruptcy court judge will not allow a distress termination of a pension plan *unless he determines that the company is unable to pay its debts* pursuant to a plan of reorganization and continue in business outside of [C]hater 11.
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> Furthermore, a pension plan termination would be allowed *only if it otherwise would force the sponsor into liquidation*; and where, for example, the court had found that the sponsor had made meaningful sacrifices, such as in its pay package agreements.[24]

[22] H.R. Rep. No. 99-300, at 279 (1985), *as reprinted in* 1986 U.S.C.C.A.N. 810, 930.

[23] *Id.* at 278; *see also US Airways*, 296 B.R. at 743; *In re Wire Rope Corp. of Am., Inc.*, 287 B.R. 771, 777 (Bankr. W.D. Mo. 2002).

[24] 133 Cong. Rec. H11970 (Dec. 21, 1987) (emphasis added).

B. Courts have consistently limited findings under the "Reorganization Test" to cases of severe business hardship.

16. A bankruptcy court's role in the distress termination process is to make a factual determination whether a debtor seeking termination has proven it will be unable to pay all its debts under a plan of reorganization and will be unable to continue in business outside of bankruptcy without terminating its pension plans.[25] The Debtors bear the burden of proving that they satisfy that test.[26] This requires a showing that "*but for* the termination of the pension plan, the debtor will not be able to pay its debts when due and will not be able to continue in business."[27]

17. Moreover, "[t]he reference in the statute to 'a' plan of reorganization does not permit a distress termination simply because a particular plan requires it; rather the test is whether the debtor can obtain confirmation of *any* plan of reorganization without termination of the retirement plan."[28] The Court's inquiry must focus on whether the Debtors will be unable to pay their debts and continue in business with the Pension Plan ongoing under *any* plan of reorganization, not just the particular plan of reorganization that has been proposed.[29] Thus, a particular plan of reorganization cannot dictate the termination decision. For example, if providers of financing or equity demand termination of a pension plan, the court must examine

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25 29 U.S.C. § 1341(c)(2)(B)(ii)(IV).

26 *Wire Rope*, 287 B.R. at 777; *US Airways*, 296 B.R. at 743.

27 *In re Resol Mfg. Co.*, 110 B.R. 858, 862 (Bankr. N.D. Ill. 1990) (emphasis added); *see also*, *US Airways*, 296 B.R. at 743; *In re Philip Servs. Corp.* 310 B.R. 802, 808 (Bankr. S.D. Tex. 2004); *Wire Rope*, 287 B.R. at 777-78; *Sewell,* 195 B.R. at 184.

28 *US Airways*, 296 B.R. at 743-44; *Philip Servs.* 310 B.R. at 808; *see also Wire Rope*, 287 B.R. at 777-78.

29 *Sewell*, 195 B.R. at 184.

whether other potential funding sources would allow the pension plans to continue under a different plan of reorganization.[30]

18. The Court's determination regarding the Reorganization Test must be based on an assessment of the Debtors' financial resources. To meet the test, the Debtors must show that those resources are insufficient to permit a reorganized debtor to fund and maintain its pension plan in accordance with ERISA and the Internal Revenue Code while fulfilling their obligations pursuant to a plan of reorganization and continuing their business outside of bankruptcy.[31] This requires a meaningful examination of the debtor's financial condition. For example, in *Sewell*, the emerging company was described as "tenuous at best," projecting negative cash flow "well into the foreseeable future."[32] The only way for the debtors in the *Sewell* case to generate sufficient cash to fund their pension plans would have been to increase sales by 70 percent in six months.[33] Similarly, the debtors in the *Wire Rope* case demonstrated that contributions exceeded available net cash flow by six million dollars over three years.[34] By contrast, in *Philip Services*, the court denied the distress motion on the basis that the pension obligation was a small percentage of the debtor's net cash provided by operations.[35] The *Philip Services* court held that "the pension obligations did not make the plan impossible, it merely makes the cost slightly higher to the Investor."[36]

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30 *Wire Rope*, 287 B.R. at 778, *Philip Servs.*, 310 B.R. at 808.

31 29 U.S.C. § 1341(c)(2)(B)(ii)(IV).

32 *Sewell*, 195 B.R. at 182.

33 *Id.* at 186.

34 *Wire Rope*, 287 B.R. at 776.

35 *Philip Servs.*, 310 B.R. at 806.

36 *Id.*

C. The Debtors have thus far failed to make the requisite factual showing under the Reorganization Test

19. In their Distress Motion, the Debtors fail to prove, let alone allege, that they cannot support the Pension Plan. Instead, they merely state that they "will be unable to obtain the exit financing necessary to allow the Debtors to reorganize and emerge as viable entities"[37] and that "[a]bsent termination of the Pension Plan, for the plan years 2011-2015, the Debtors would be required to make minimum funding contributions to such plans in the aggregate amount of more than $24 million."[38] These vague and unsupported statements fall far short of the required "but for" showing.

20. Presumably recognizing that their financial condition easily allows for continuation of the Pension Plan, the Debtors have not focused on affordability, but rather on termination as purportedly necessary to appease their lenders and investors.

21. The facts of this case are quite similar to *Philip Services*.[39] As here, equity investors were demanding termination of the debtor's defined benefit pension plans as a condition of investment.[40] The court rightly rejected the "*ipse dixit*" argument "that the pension plans must be terminated because the Investor said they must be terminated."[41] The court noted that "[a]ccepting *that* argument would be tantamount to allowing the Investor to make the decision reserved to the bankruptcy court under ERISA."[42] The court found that the "existential

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37 Motion at ¶ 28.

38 Motion at ¶ 29.

39 310 B.R. 802.

40 *Id.* at 804.

41 *Id.* at 808.

42 *Id*.

financial reality" rebutted the Investor's "self-serving, speculative, and hedged" testimony, and the court noted that there had been competing offers for the company.[43]

22. In summary, the Court's factual determination should be based not simply on the Debtors' self-serving and questionable assertion that it is financially strapped or that its lenders and investors "may" not provide financing without termination of the Pension Plan, but upon actual evidence that establishes that termination is the *only* way that the Debtors will be able to reorganize and continue in business outside the Chapter 11 reorganization process.[44]

IV. RESERVATION OF RIGHTS

PBGC expressly reserves all of PBGC's claims, defenses, and rights to assert further objections or supplement current objections to the Motion and any modifications thereof.

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[43] *Id.*

[44] *See* Motion at ¶¶ 28-40. *See Wire Rope*, 287 B.R. at 777-78.

V. CONCLUSION

For the foregoing reasons, the Court should deny the Motion based on its legal inadequacy. Alternatively, it should defer its rulings on the Motion until a full evidentiary hearing is completed after PBGC has had a meaningful opportunity for discovery with respect to the significant and complicated issues that the Motion presents.

Dated: June 7, 2011
Washington, D.C.

Respectfully submitted,

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